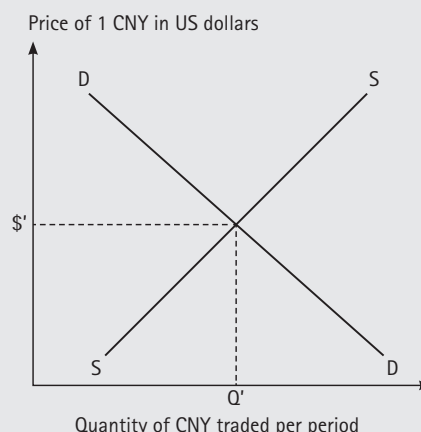


H36 Can a trade surplus be unfavourable?

8.2 Balancing international payments

- 1 What is a trade surplus?
- 2 Why was China's large and growing trade surplus during the last decade a cause for concern?
 - (i) In countries that trade with China
 - (ii) In China
- 3 As China's trade surplus grows what should be the impact of this on the Chinese currency the yuan renminbi (CNY)? Show the likely effect in the diagram opposite.
- 4 How could an expansionary fiscal and monetary policy in China help to reduce its trade surplus?



The problem with China's trade surplus

The growth rate of China's exports slowed in August, but the trade surplus remains high despite the government's efforts to trim the ballooning figure.

The trade surplus was US\$24.97 billion last month, the second highest in history after US\$26.91 billion in June. Exports totalled US\$111.36 billion, up 22.7 percent from a year earlier according to Customs figures. Imports reached US\$86.38 billion, up 20.1 per cent from a year earlier.

Trade surpluses occurring now and then for some months or even for a few years are not bad because short-lived trade surpluses can be offset by trade deficits over time. Problems arise, however, if there is a continuous, consistent situation of only trade surpluses (or deficits) month after month and year after year.

Consistent trade surplus has two problems. In a free market situation in the exchange market, this would mean continuous pressure of the

country's currency to appreciate which hurts future export growth and which makes imports cheaper and thereby hurts domestic production.

Initially, for a developing country to get into high exports is emotionally very satisfying and increasing foreign exchange reserves looks good. But in real economic terms this can be a great problem. The continuous inflows of foreign earnings to the country from the sale of exports are converted into Yuan. The extra supply of Yuan continuously builds up local demand and therefore stokes inflation at home. There is growing concern about rapid wage and price inflation in China.

Meanwhile, the rising trade surplus highlights other problems including the country's over dependence on the sale of exports to overseas markets while domestic demand remains low and sluggish because, unfortunately, many Chinese people remain poor. So China is also unable to import in a large way.